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25 July 2008

VIA HAND DELIVERY

Karen Nickerson, Secretary
Delaware Public Service Commission
861 Silver Lake Boulevard
Cannon Building, Suite 100
Dover, DE 19904

Re: *In the Matter of Integrated Resource Planning for the Provision of
Standard Offer Service by Delmarva Power & Light Company
under 26 Del. C. § 1007(c) & (d): Review and Approval of the
Request for Proposals for the Construction of New Generation
Resources under 26 Del C. § 1007(d) (opened July 25, 2006) PSC
Docket No. 06-241*

Dear Ms. Nickerson:

Enclosed herewith please find an original and 10 copies of Staff's Comments on the
Negotiated Power Purchase Agreement Between Delmarva Power & Light Company and
Bluewater Wind LLC.

Please call me should you have any questions regarding this matter. Thank you for your
assistance.

Respectfully submitted,


James McC. Geddes

Enclosures

JMcCG:bel

cc: Service List (via e-mail only)

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE
AND THE DELAWARE ENERGY OFFICE
THE OFFICE OF MANAGEMENT AND BUDGET
AND THE CONTROLLER GENERAL**

IN THE MATTER OF INTEGRATED RESOURCE)	
PLANNING FOR THE PROVISION OF STANDARD)	
OFFER SERVICE BY DP&L POWER &)	
LIGHT COMPANY UNDER 26 <i>DEL. C.</i> §1007(c))	
& (d): REVIEW AND APPROVAL OF THE REQUEST)	PSC DOCKET NO. 06-241
FOR PROPOSALS FOR THE CONSTRUCTION OF)	
NEW GENERATION RESOURCES UNDER)	
26 <i>DEL. C.</i> §1007(d)(Opened July 25, 2006))	

**COMMENTS OF THE DELAWARE PUBLIC SERVICE COMMISSION STAFF ON THE
PROPOSED FINAL POWER PURCHASE AGREEMENT BETWEEN DELMARVA POWER &
LIGHT COMPANY AND BLUEWATER WIND LLC**

Delaware Public Service Commission Staff
861 Silver Lake Boulevard
Cannon Building, Suite 100
Dover, Delaware 19904
Phone: 302-736-7500

Dated: July 25, 2008

I. Background.

In March 2006, the Delaware General Assembly introduced House Bill No. 6¹ (“the EURCSA”) in response to extensive consumer outrage occasioned by the announcement of imminent and significant rate increases resulting from the higher cost of fuel used to generate electricity and the shift to PJM market-based prices. The cumulative effect of these increases was felt by Delmarva Power & Light Company (“Delmarva”) customers at one time due to the expiration of rate freezes established with deregulation of Delaware’s electric supply industry. The purpose of the EURCSA was to spread out the impact of the rate increases and enable certain state agencies to explore alternative options of SOS² procurement at reasonable and stable prices. The legislation specifically required Delmarva to develop an Integrated Resource Plan (“IRP”) and “investigate all possible opportunities for a more diverse supply at the lowest reasonable cost.”³ On or before August 1, 2006, as part of its IRP, Delmarva was required to file a proposal to obtain long-term contracts, including a proposed Request for Proposal (“RFP”) for the construction of new generation resources within Delaware to serve its SOS customers.

The EURCSA specifically directed the Delaware Public Service Commission (“the Commission”), in conjunction with the Delaware Energy Office, the Controller General, and the Director of the Office of Management and Budget (collectively “the State Agencies”), to evaluate the proposals received pursuant to the RFP and “determine to approve one or more of such proposals that result in the greatest long-term system benefits ... in the most cost-effective manner.”⁴ The State Agencies retained an Independent Consultant (“the IC”), a consulting team

¹ HB 6 is codified in the Electric Utility Retail Customer Supply Act of 2006, 26 *Del. C.* §§ 1001-1019.

² SOS refers to Delmarva customers who do not receive their energy supply from a third-party electric provider. 26 *Del. C.* § 1001(18).

³ 26 *Del. C.* § 1007(c)(1)b.

⁴ *Id.* at § 1007(d)(3).

led by New Energy Opportunities, Inc., to oversee development of the RFP and assist the State Agencies during the bid evaluation.

Following the EURCSA's mandate, Delmarva filed its proposed RFP on August 1, 2006. In October 2006, the Commission and Energy Office adopted a "big funnel" approach and developed the criteria to be included in Delmarva's RFP that would guide the evaluation of the potential bids. On December 21, 2006, Conectiv Energy Supply, Inc. ("Conectiv") submitted a primary and alternate bid for a 180 MW combined cycle gas turbine ("CCGT") located at its Hay Road site in Edgemoor, Delaware. The following day, Bluewater Wind LLC ("Bluewater") submitted twelve variations of a bid proposal that included both 20- and 25- year terms and (1) a 600 MW capacity plant with a 400 MW energy limit or (2) a sale of two-thirds of the energy from a 600 MW plant. That same day, NRG Energy Inc. ("NRG") submitted a proposal to sell energy and unforced capacity credits from 400 MW of a 600 MW coal-fired integrated gasification combined cycle ("IGCC") facility to be constructed at its Indian River site.

On February 21, 2007, Delmarva and the IC filed bid evaluation reports. Both Delmarva and the IC ranked the bids as follows: (1) Conectiv; (2) Bluewater; and (3) NRG. Delmarva concluded that none of the bids achieved the EURCSA's objective because each bid was above the market forecast and produced minimal price stability. Delmarva asserted that the EURCSA's objectives could be satisfied with demand side management ("DSM") programs and energy purchases from the regional market. The IC recommended deferring a financial decision on the proposals pending Staff's analysis of reliability and economics. The IC also suggested employing a market test to evaluate other regional options.

On May 3, 2007, Staff issued the "PSC Staff Review and Recommendations on Generation Bid Proposals," ("Generation Bid Report") in which it recommended that the State

Agencies adopt a portfolio approach to energy planning that would involve the addition of new generation assets in southern Delaware, development of DSM and energy efficiency programs, renewable distributed generation, short- and long-term bilateral contracts, and market purchases. With respect to the generation bids, Staff recommended that the State Agencies direct Delmarva to negotiate with both Conectiv and Bluewater for a hybrid energy supply that would combine a 200-300 MW offshore wind farm with a 150-200 MW synchronous condenser CCGT in Sussex County.

On May 22, 2007, by Order No. 7199, the State Agencies accepted Staff's proposed energy supply portfolio and directed Delmarva to negotiate in good faith with Bluewater for a long-term power purchase agreement ("PPA") for the provision of offshore wind power. The Order further instructed Delmarva to negotiate independently with both Conectiv and NRG to provide any necessary backup firm power to ensure reliability when wind power is not available and directed that the negotiations for the backup power be conducted at the same time as the Bluewater-Delmarva negotiations. The Order provided that the negotiations conclude within a 60-day time frame, but the State Agencies indicated their flexibility in extending this deadline, if necessary, to the extent that there was continuing progress in the PPA negotiations. The State Agencies also directed the Staff to retain a third party to oversee the progress of the negotiations and report back periodically to the State Agencies regarding the status of the negotiations and the efforts of all parties to negotiate the PPAs in good faith as well as to conform with the EURCSA. Staff hired Lawrence A. Hamermesh, Esquire, to perform this oversight function as directed by the State Agencies.

During the summer months of 2007, the parties engaged in PPA negotiations and provided a status report to the State Agencies on August 7, 2007. Aspiring for completed PPAs

by the end of 2007, the State Agencies directed Delmarva to circulate detailed Term Sheets outlining the material terms of arrangements with Bluewater and the backup firm providers by September 14, 2007.⁵ Delmarva filed all three Term Sheets as directed on September 14, 2007.

On October 29, 2007, Staff issued the “PSC Staff Report On the Term Sheets for Proposed Power Sales to Delmarva Power” (“the Term Sheet Report”), in which it recommended that the State Agencies deny approval of all three Term Sheets, consider the Bluewater proposal under specific parameters that would address the concerns raised by Staff, and continue exploration of portfolio energy supply options in the ongoing IRP process. Staff determined that Bluewater’s revised proposal in the Term Sheet did not achieve the greatest long-term system benefits in the most cost-effective manner in light of the significant risk and cost imposed on the SOS ratepayers by the asymmetrical pricing escalator combined with the delay in the timing of the revised proposal. In response to the Term Sheet Report, Bluewater withdrew the pricing escalator from its proposal on November 6, 2007.

Following extensive comment from the participants and the public regarding the merits of the Term Sheets, the State Agencies directed Bluewater and Delmarva to continue negotiations for a finalized contract for the procurement of offshore wind power in Delaware.⁶ The State Agencies limited the scope of the Bluewater-Delmarva negotiations to issues regarding price, non-conforming terms, and disputed contract terms. The State Agencies further empowered Mr. Hamermesh to resolve all outstanding issues in the proposed contract that would be brought before the State Agencies on December 18, 2007 for their final decision on the offshore wind proposal. When the final PPA was presented to the State Agencies on December 18, 2007, the

⁵ See PSC Order No. 7277 (September 4, 2007).

⁶ See PSC Order No. 7328 (December 4, 2007).

State Agencies unanimously voted to table the matter because there was not a consensus to approve the PPA in its current form.⁷

During the spring months of 2008, the Senate Energy and Transit Committee conducted a series of hearing related to Delaware's energy options and the RFP process. At the conclusion of those hearings, Bluewater and Delmarva resumed negotiations – with the facilitation of Delaware Senate Majority Leader Anthony DeLuca – culminating in a negotiated PPA executed by both parties. Staff respectfully submits the following comments regarding the proposed Bluewater-Delmarva PPA executed on June 23, 2008 (“the Final PPA”) and the future process governing the State Agencies’ consideration of arrangements with CESI and/or NRG for additional generation resources in Sussex County.

II. The Final PPA.

The Final PPA requires Delmarva to purchase the energy, capacity, and Renewable Energy Credits (“RECs”) produced by 200 MW of installed capacity – a significant reduction from the PPA proposed on December 18, 2007. However, the Final PPA allows Bluewater to expand the offshore wind facility for a maximum total of 600 MW of installed capacity in the event that Bluewater procures additional third party buyers. The Final PPA further provides Bluewater termination rights until June 23, 2010 if it is unable to secure satisfactory buyers for the unsold energy. Bluewater agreed to a qualified most favored nation clause to allow Delmarva to benefit from the lower prices if Bluewater or an affiliate enters into a more favorable agreement with another purchaser prior to financial closing of the project. Notably, Delmarva agreed not to appeal or otherwise challenge regulatory approval of the Final PPA.

With regard to price, energy and capacity prices are identical to the December 18, 2007 draft of the PPA, but the Final PPA reduces REC prices from \$19.75 to \$15.32 (2007\$). A

⁷ See December 18, 2007 Tr. at 2308-2310.

critical condition precedent to the Final PPA is the General Assembly's enactment of two amendments to the Delaware Code: (1) establishing a 350% credit towards obligations under Delaware's Renewable Portfolio Standard ("RPS") for RECs purchased by Delmarva from the wind facility; and (2) establishment of an adjustable non-bypassable surcharge allocating all costs under the Final PPA to Delmarva's Delaware distribution customers. Notably, on June 25, 2008, the General Assembly unanimously passed Senate Bill 328 that created the 350% REC multiplier⁸ and a non-bypassable surcharge⁹ allocating the Final PPA's costs across Delmarva's entire Delaware distribution customer base.¹⁰

The ongoing negotiations between Bluewater and Delmarva produced more favorable pricing provisions for Delmarva's customers in the Final PPA. In its July 3, 2008 report, the IC concluded that the forecasted customer bill impact to Delmarva's ratepayers is substantially less than the customer bill impact of the December 18, 2007 PPA. The IC projected that the overall rate impact to Delmarva's Delaware distribution customers would be \$0.70/MWh in real levelized 2007 dollars under the Final PPA. By comparison, the IC projected a real levelized cost impact of \$6.46/MWh to SOS customers pursuant to the terms of the December 18, 2007 PPA. The IC reasoned that higher forecasted energy market prices, lower quantities of energy purchases from Bluewater, lower REC prices, and a larger customer base to allocate net costs diminished the forecasted rate impact in the Final PPA. Moreover, the IC determined that the

⁸ 26 Del. C. § 356(c) provides: "[a] Commission regulated electric company shall receive 350% credit toward meeting the Renewable Energy Portfolio Standards established pursuant to this subchapter for energy derived from offshore wind energy installations sited off the Delaware coast on or before May 31, 2017."

⁹ 26 Del. C. § 364 provides: "[a]ll costs arising out of contracts entered into by a Commission regulated electric company pursuant to §1007(d) of this Title shall be distributed among the entire Delaware customer base of such companies through an adjustable non-bypassable charge which shall be established by the Commission. Such costs shall be recovered if incurred as a result of such contracts unless, after Commission review, any such costs are determined by the Commission to have been incurred in bad faith, are the product of waste or out of an abuse of discretion, or in violation of law."

¹⁰ Staff recommends that the State Agencies' consider the institutional support for the Bluewater project in evaluating the Final PPA.

Final PPA is commercially reasonable in terms of its risk allocation between Bluewater and Delmarva under the particular circumstances presented by Bluewater's proposal and the hurdles the parties faced in reaching a voluntary agreement.¹¹

From a policy standpoint, the Final PPA presents a number of long-term system benefits provided for under the EURCSA. First and foremost, price stability – the primary goal of the EURCSA – is a principal attribute of the Final PPA.¹² The Final PPA establishes new, innovative generation that promotes fuel diversity in Delaware. The delivered cost of fuel to power plants throughout PJM is the single largest determinant of electric energy prices. Natural gas is the primary fuel of critical relevance in setting energy prices in the PJM market. The long-term outlook for natural gas prices reflects robust demand and increased reliance on imported natural gas supplies from the Middle East, the Former Soviet Union, and Africa for which the U.S. must compete with Asia and Europe. Accordingly, over the long-term, natural gas prices are expected to remain high by historic standards and also extremely volatile. Moreover, as electricity consumers across the nation have painfully learned, the thin margin between the U.S. supply and demand can have disastrous effects on price in the event of natural disasters or pipeline disturbances. The Final PPA would reduce Delaware's reliance on wholesale market prices dictated by natural gas prices, and accordingly, would dampen SOS ratepayers' exposure

¹¹ Staff agrees with the IC's concern regarding the 350% RPS multiplier. Staff observes that this amendment to Title 26 dilutes the RPS and could soften the REC market posing financial constraints to development of future renewable energy resources in Delaware. However, the multiplier was critical in achieving a consensual agreement during the long and arduous PPA negotiations.

¹² The risk associated with the project's long lead time is mitigated by the non-bypassable surcharge established under Senate Bill 328 and the Final PPA's provision for termination rights if Bluewater determines that the project is not economically feasible prior to June 23, 2010.

to price volatility. Delaware's captivity to the volatility of the PJM market and its RPM rules is the precise ground for Staff's May 3, 2007 recommendation that Delaware take control of its energy future through a diverse energy supply portfolio. In addition to integrating appropriately into the energy supply portfolio, innovative offshore wind energy technology¹³ reduces reliance on fossil fuels that emit carbon dioxide and other greenhouse gases. The production of carbon free energy is undoubtedly an attractive feature of the PPA, particularly in light of federal greenhouse gas regulations that are expected to be implemented prior to the project's in-service date, and the positive health impacts in Delaware and the surrounding region associated with clean energy.

Second, the production of clean energy from Bluewater's proposed wind facility provides long-term environmental benefits to Delaware. As many of the proponents of the wind project have reiterated throughout the RFP proceeding, the forging of offshore wind power in Delaware – the first of such facilities in the United States – would unquestionably be a major contribution to addressing climate change. At the November 20, 2007 hearing, Former Governor Russell Peterson explained that the nation is engaging in a transition toward green energy in response to global warming. On a national level, several state leaders, including Montana's governor, have taken steps to promote renewable energy and the Court of Appeals for the Ninth Circuit recently rejected a fuel standard established by the Bush Administration for failure to adequately reduce greenhouse gas emissions. Because of the Bush Administration's failure to initiate a federal program, the State of Delaware – through the leadership of Governor Minner – has entered into a Memorandum of Understanding with nine other Mid-Atlantic and Northeastern states to reduce each state's carbon footprint, through the Regional Greenhouse Gas Initiative ("RGGI").

¹³ The PPA will also create new, construction-related Delaware jobs and will have some positive impact on economic development in the State.

Specifically, RGGI targets a reduction in carbon emissions from fossil fuel generating plants in the participating states. In Delaware, on July 24, 2007, the General Assembly doubled the RPS percentage requirement for retail electric suppliers to 20% by 2019, which includes 2.005% for solar photovoltaics (“PV”).¹⁴ As a result of this amendment, Delaware has one of the most aggressive RPS requirements in the United States. By comparison, Maryland’s and Pennsylvania’s RPS are 7.5% by 2019¹⁵ and 8-10% by 2020,¹⁶ respectively. New Jersey – a leader in the promotion of green energy – also has an aggressive RPS percentage requirement of 22.5% by 2021, which includes 7.5% for solar PV.¹⁷ Execution of the Bluewater-Delmarva PPA will facilitate construction of the Bluewater project which will play a major role in satisfying Delaware’s RPS.

In light of the voluntary nature of the agreement, the minimal rate impact on Delmarva’s ratepayers, the significant long-term system benefits provided under the PPA, and immense public and institutional support thereof, Staff recommends that the State Agencies approve the Final PPA executed between Bluewater and Delmarva on June 23, 2008. Within the conceptual framework of the EURCSA, Staff concludes that the 25-year arrangement between Bluewater and Delmarva for the procurement of offshore wind power is the preferred solution to promote long-term system benefits in the most-cost effective manner. The uncertainty regarding Delaware’s energy future is the major consideration underlying Staff’s decision. The PPA provides parameters of certainty and stability to this uncertain energy future and, accordingly,

¹⁴ “An Act to Amend the Delaware Code to Increase the Renewable Energy Portfolio Standard.” See 76 Del. Laws ch. 165 sections 1-9 (July 24, 2007).

¹⁵ See *Md. Code Ann.* Public Utility Companies § 7-701(i).

¹⁶ Pennsylvania’s RPS provides a range that varies based on the renewable energy source employed. See 73 P.S. §§ 1648.1-1648.8.

¹⁷ See *N.J.S.A.* § 48:3-49, et seq.

Bluewater's project is a cost-effective mechanism that takes control of Delaware's energy needs and provides a price hedge against the unpredictable and volatile movement of the PJM market.

III. Procedural Recommendations for Additional Generation Resources.

By Order No. 7328 (Dec. 4, 2007), the State Agencies disaggregated their review of the proposed Bluewater PPA from the proposed PPAs for backup generation resources. Delmarva argues that a backup facility is not necessary in light of its contractual arrangement with regional onshore wind developers. However, system reliability was an equally important factor – along with firming power – driving Staff's recommendation for developing new generation assets. The feasibility of the Mid-Atlantic Power Pathway ("MAPP") project proposed by PJM is uncertain in light of concerns regarding timing and financing. Even with successful implementation of the MAPP, self-generation empowers Delaware to address system reliability concerns in the PJM power grid. Moreover, Staff believes that self-generation could also help insulate Delmarva customers from certain shortcomings of the PJM wholesale market that, in Staff's opinion, causes Delaware electric customers to pay higher prices than necessary for electric supply.

Staff believes that the IRP docket is the most appropriate proceeding for the State Agencies to consider the arrangements outlined in the draft PPAs between Delmarva and the backup providers as well as the potential for new generation resources in Sussex County. The IRP process is more comprehensive and is a fully litigated proceeding which would provide for sworn testimony, discovery, and cross-examination of witnesses. The EURCSA requires Delmarva to systematically evaluate all supply options in its IRP.¹⁸ The EURCSA permits Delmarva to consider the factors such as innovative baseload technology, environmental

¹⁸ See 26 Del. C. § 1007(c)(1).

attributes, existing fuel and transmission infrastructure, utilization of brownfield or industrial sites, fuel diversity, reliability, and price stability.¹⁹ Although it could be disputed that the EURCSA formally confers authority on the Commission to compel Delmarva to take action proposed in its IRP, Delmarva testified, on the record, that it would follow any Commission direction made in the IRP Docket.²⁰ The IRP docket provides a comprehensive proceeding to address the implications of the reduction of the Bluewater project, the integration of onshore wind resources into Delaware's portfolio, the volatile regional capacity market, and future energy efficiency programs initiated by the Sustainable Energy Utility on new generation assets in Delaware. Accordingly, Staff recommends that the State Agencies close PSC Docket No. 06-241 and review the potential for new generation resources in Sussex County – including the backup generation proposals – in the context of PSC Docket No. 07-20.

IV. Staff's Recommendation.

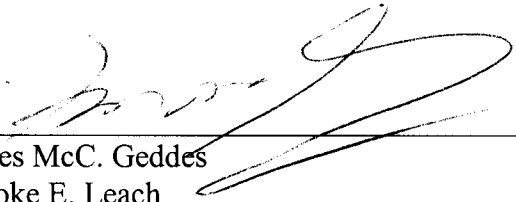
In light of the foregoing, Staff recommends that the State Agencies approve the Final PPA to take a significant step in taking control of Delaware's energy future and addressing climate change. Staff further recommends that the State Agencies close PSC Docket No. 06-241 and investigate the potential for new generation resources in the context of the IRP process.

¹⁹ See 26 Del. C. §1007(c)(1)b.

²⁰ See November 20, 2007 Tr. at 2228-2229, 2243.

Respectfully submitted,

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